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Functional Regulation of Bank Insurance Activities: The Time Has Come

I. INTRODUCTION

The insurance and banking industries have been fighting for years over the expansion of banks into the insurance market.¹ Battles have raged between bank and insurance regulators, in courtrooms across the nation, and in the halls of Congress.² However, in response to market forces,³ court rulings,⁴ and other recent developments,⁵ the insurance industry has reconsidered its long-held resistance to increased bank involvement in insurance.⁶ Conceding

1. See *infra* notes 42-95 and accompanying text.

2. See *infra* notes 42-95 and accompanying text.

3. See generally Peter Duran, *Insurance and Banks: Is the Fight Over?*, ERNST & YOUNG INS. EXECUTIVE, Spring 1997, at 3, 5. The insurance industry needs an improved distribution system and a way to better capitalize on technological advances. See *id.* The current agency and brokerage method is inefficient and expensive. See *id.* In addition, affiliations with banks can provide an insurer with access to technological advances already implemented by the banks. See *id.* For example, customer databases and internet access at banks can be used to more effectively identify and reach potential customers. See *id.*; see also Michelle Clayton, *IIAA Switch Could Fuel Restructurings*, THE INS. ACCT., Jan. 27, 1997, available in 1997 WL 7885569 (citing Paul Equale, Senior Vice President of Government Affairs, Independent Insurance Agents of America (IIAA), who noted marketplace convergence of the financial services industry as a reason for the IIAA's new position on bank and insurance affiliations).

4. See, e.g., *Barnett Bank v. Nelson*, 517 U.S. 25 (1996); *NationsBank of North Carolina v. Variable Annuity Life Ins. Co.*, 513 U.S. 251 (1995); *Independent Ins. Agents of Am. v. Ludwig*, 997 F.2d (D.C. Cir. 1993); see also *infra* notes 55-66 and accompanying text.

5. For example, the Office of the Comptroller of the Currency has issued a series of new opinions and regulations significantly expanding bank insurance powers. See *infra* notes 55-82 and accompanying text.

6. See Mark H. Anderson, *U.S. Insurers Moderate Stance on Financial Services Reform*, DOW JONES NEWS SERV., Feb. 11, 1997, available in WESTLAW, ALLNEWSPLUS Database (noting that the American Council of Life Insurance (ACLI), the largest trade group for the insurance industry, has "reversed its policy on affiliations and hopes that this action will facilitate the development of legislation that is fair across the board") (quoting Roy Albertalli, Vice President, ACLI, at a House Banking Committee hearing on financial services reform); see also *Insurance Agents to End Turf War with Banks*, BEST'S INS. NEWS, Jan. 16, 1997, available in 1997 WL 7077128 (citing a policy statement issued by Paul A. Equale, Senior Vice President for Governmental Affairs for the IIAA at a Jan. 16, 1997 news conference).

their losses on the regulatory and judicial fronts, insurance interests are now looking toward compromise with the banking industry.⁷ The insurance industry has reversed its long standing opposition to bank and insurer affiliations and now, subject to certain conditions,⁸ is pursuing the opportunity to join forces with banking interests.⁹

On the other hand, national banks, which are the focus of this Comment,¹⁰ were once strong proponents of legislative reform that would allow access to insurance markets, but now may no longer be as eager for financial modernization legislation.¹¹ This change in

7. See *infra* notes 96-113 and accompanying text.

8. See Alan Yonan Jr., *Insurance Agents Vow to Work with Banks on Reform Bill*, DOW JONES NEWS SERV., Jan. 16, 1997, available in WESTLAW, ALLNEWSPLUS Database (“‘IIAA supports financial services affiliations with two vital conditions: First, state regulation of insurance must be preserved through absolute functional regulation. Second, adequate consumer safeguards must be adopted, either at the federal or state level, or at both levels.’”) (quoting an IIAA policy statement issued on Jan. 16, 1997).

9. See *Insurance Agent's to End Turf War with Banks*, *supra* note 6. Paul A. Equale, Senior Vice President of Government Affairs for IIAA, stated, “The market place has changed [and insurance agents] should look toward the next 50 years, not look back at the last 50 years.” *Id.* In addition, Ronald A. Smith, President of IIAA, is quoted as saying:

to the banks we say, come talk to us. IIAA members want to set up joint marketing arrangements. If you want to sell insurance, come talk to the insurance experts. Additionally, many IIAA member agencies want to explore offering your products to customers. Yes, the market is evolving, but customers still want and demand professional expertise and service.

Id.

10. This Comment focuses primarily on the activities of national banks because currently national banks have the best opportunity of bank and bank affiliated institutions for expansion into insurance related activities. See *infra* notes 42-95 and accompanying text (discussing the insurance powers of national banks). Although nonbanking subsidiaries of bank holding companies and state banks are engaging in insurance activities, these activities are limited and provide less opportunity for expansion. Nonbanking subsidiaries of bank holding companies are permitted to engage in activities closely related to banking, however, their insurance activities were dramatically reduced in 1982 when Congress amended the Bank Holding Company Act in the Garn-St. Germain Depository Institutions Act of 1982. See 12 U.S.C. § 1843(c)(8) (1994) (indicating that “for purposes of this subsection it is not closely related to the business of banking or managing or controlling banks for a bank holding company to provide insurance as a principal, agent, or broker”). The Act does, however, provide for limited insurance activities including certain grandfathered activities, credit related insurance, agency activities in small towns, and agency activities of certain small bank holding companies. See *id.* A state bank, regulated by the appropriate state authority, must be permitted by state law to engage in insurance activities. Furthermore, even if permitted by state law, since 1992 state banks have been specifically prohibited from engaging in insurance underwriting except to the extent permitted for national banks. See 12 U.S.C. § 1831a(b).

11. See *ACLI Chief Sees Continued Bank-Insurance Conflict*, BEST'S INS. NEWS, Oct. 8, 1997, available in 1997 WL 7078914. Carroll Campbell, Jr., President and Chief Executive Officer of the American Council of Life Insurance and former governor of South

attitude comes as a result of recent court decisions and administrative rulings that have given national banks increased opportunities in the world of insurance despite a lack of legislative changes.¹² However, discontent in the legislature could threaten current and future bank insurance powers.¹³ Thus, national banks should also be ready to sit at the negotiating table in an atmosphere of compromise.

Both the banking and insurance industries see advantages in affiliations. However, an issue has arisen regarding the appropriate regulatory structure.¹⁴ Currently, national banks are regulated at the federal level by the Office of the Comptroller of Currency (OCC), and insurance companies are regulated by the states.¹⁵ As national banks begin to cross traditional industry lines; however, the current regulatory responsibilities begin to overlap.¹⁶ As a result, conflicts have developed when trying to fit the new bank insurance activities into the existing regulatory structure. The debate is over which regulator is responsible for the different financial transactions.¹⁷ Some argue that regulation should be based on the organization that conducts the transaction or entity regulation, while others believe that regulation should be according to the transaction or functional

Carolina, is noted as saying that bankers are "convinced they're getting a better deal from the Comptroller and the courts than from the legislators, so 'they're not anxious to see any reform bill passed.'" *Id.*

12. See *infra* notes 42-95 and accompanying text.

13. A financial modernization bill, entitled the Financial Services Competition Act of 1997, approved by the House Banking Committee on June 20, 1997, "contains significant rollbacks in the current authority of national banks, imposes unique new burdens on all banks relative to their competitors, and imposes new sets of regulatory requirements." *OCC Lawyer Slams Financial Modernization Bill*, BEST's INS. NEWS, July 7, 1997, available in 1997 WL 7078222 (quoting Letter from Julie Williams, General Counsel, Office of the Comptroller of Currency, to Eugene Ludwig, Comptroller of the Currency, June 24, 1997) (on file with OCC).

14. See *infra* notes 123-79 (discussing functional versus entity regulation).

15. See *infra* notes 24-41 and accompanying text.

16. For example, the OCC has recently issued guidelines to banks for selling insurance discussing the application of state insurance laws and the extent to which those laws will be applicable to national banks. See OCC Advisory Letter 96-8, Guidance to National Banks on Insurance and Annuity Sales Activities, [Vol. 4 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 35-463 (Oct. 8, 1996) [hereinafter OCC Advisory Letter 96-8].

17. See *infra* notes 123-40 and accompanying text.

regulation.¹⁸ This Comment evaluates the advantages and disadvantages of functional versus entity regulation.¹⁹

Part II of this Comment provides background information regarding the banking and insurance industries' historical roles and the most recent changes in those roles.²⁰ Part III provides details on the current state of affairs, including the change in the insurance industry's position regarding bank and insurer affiliations and the push for financial modernization.²¹ Part IV discusses financial reform and suggests that section 92 of the National Bank Act should be repealed and replaced with comprehensive and unified financial legislation. It further discusses functional versus entity regulation and suggests that reform should pave the way for financial services affiliations operating under a functional, rather than institutional, regulatory scheme.²² Finally, Part V concludes that legislative change is inevitable and compromises and concessions from both industries are necessary to ensure positive steps are taken toward effective and beneficial financial reform.²³

II. BACKGROUND

A. *Early Insurance and Banking Roles*

National banks are regulated by the OCC within the Department of the Treasury.²⁴ The National Bank Act provides the statutory authority for the powers of national banks.²⁵ Specifically, section 24 (Seventh) indicates that national banks are authorized to engage in deposit taking, credit granting, credit exchange, and "all such incidental powers as shall be necessary to carry on the business of banking."²⁶ Until 1916, it was universally understood that insurance was not incidental to banking and thus national banks were

18. See *infra* notes 123-40 (discussing functional versus entity regulation).

19. See *infra* notes 123-40 and accompanying text.

20. See *infra* notes 24-95 and accompanying text.

21. See *infra* notes 96-113 and accompanying text.

22. See *infra* notes 114-92 and accompanying text.

23. See *infra* notes 193-94 and accompanying text.

24. See 12 U.S.C. § 93(a) (1994).

25. See *id.* §§ 21-216d.

26. *Id.* § 24 (Seventh).

prohibited from engaging in the business of insurance.²⁷ Section 24 (Seventh), therefore, was not originally seen as a source for bank insurance powers. Subsequently, on September 7, 1916, due to growing concern over the financial stability of nationally chartered banks in small towns,²⁸ Congress enacted section 92 of Title 12 of the United States Code.²⁹ Section 92 permits national banks located in towns of less than five thousand in population to act as insurance agents.³⁰ The primary congressional purpose of section 92 was to provide another source of income for the struggling national banks that were located in small towns.³¹ As a result, for at least the first half of the century, it was understood that this source of bank insurance powers, specifically agency activities,³² would be limited geographically to customers in these small communities.³³

27. See *Saxon v. Georgia Ass'n of Indep. Ins. Agents, Inc.*, 399 F.2d. 1010, 1013 (5th Cir. 1968) (noting that "prior to the 1916 enactment of [s]ection 92 it seems to have been universally understood that no national bank possessed any power to act as insurance agents").

28. See generally Kevin M. Lesperance, *A Unique Preemption Problem: The Insurance and Banking Industries Engage in War*, 31 VAL. U. L. REV. 1141 (1997).

29. The statute provides, in relevant part, the following:

In addition to the powers now vested by law in national banking associations organized under the laws of the United States any such association located and doing business in any place the population of which does not exceed five thousand . . . may, under such rules and regulations as may be prescribed by the Comptroller of the Currency, act as the agent for any fire, life, or other insurance company authorized by the authorities of the State in which said bank is located to do business in said [s]tate

12 U.S.C. § 92.

30. See *id.*

31. See Lesperance, *supra* note 28, at 1150 (citing Letter from John Skelton Williams, Comptroller of the Currency, to Congress, 53 CONG. REC. 11,001 (1916)). At the time of its enactment, section 92 left the general rule regarding a bank's insurance power mostly intact, providing only a limited exception. See *id.* In a letter to Congress, then Comptroller of the Currency, John Skelton Williams, noted that it is "desirable from the standpoint of public policy and banking efficiency that [authority to sell insurance] should be limited to banks in small communities." *Id.* at 1150 n.67. He further noted that the additional income would strengthen the small town bank's financial position; however, due to the limited insurance markets in these small communities, the activity would not be enough to distract the bank from its primary purpose of a lending and depository institution. See *id.*

32. Section 92 expressly provides for insurance agency activity. It does not, however, provide banks with power to underwrite insurance. See 12 U.S.C. § 92.

33. See *Saxon v. Georgia Ass'n of Indep. Ins. Agents, Inc.*, 399 F.2d. 1010, 1016 (5th Cir. 1968). While not directly addressing the issue of whether a national bank in a small

The insurance industry, on the other hand, has traditionally been and currently is regulated by the states.³⁴ Up until 1944, the courts had interpreted the business of insurance as outside of the Commerce Clause and, thus, not subject to federal regulation.³⁵ However, the Supreme Court in *United States v. South-Eastern Underwriters Ass'n*³⁶ reversed this position and held that insurance was commerce within the meaning of the Commerce Clause.³⁷ The result of this ruling was that insurance activities could, in fact, be subject to federal regulation.³⁸

Congress reacted swiftly, however, to return the insurance powers back to the states. In 1945, the McCarran-Ferguson Act³⁹ overruled the *South-Eastern Underwriters* decision proclaiming that “the continued regulation and taxation by the several states of the business of insurance is in the public’s best interest.”⁴⁰ The McCarran-Ferguson Act provides that any state statute enacted to “regulate the business of insurance” will preempt a conflicting federal statute unless the federal statute “specifically relates to the business of insurance.”⁴¹ This statute is sometimes referred to as the reverse preemption statute.

town is geographically limited to that small town, the court refers to the letter received by the then Comptroller, John Skelton Williams, discussed *supra* note 28. See *id.* Williams supported the adoption of section 92 and indicated that “the amount of insurance policies written or mortgages to be placed on commission is not sufficient to take up the entire time of an insurance broker, and the bank is not therefore likely to trespass upon outside business naturally belonging to others.” *Id.*; see also Lesperance, *supra* note 28.

34. See Lesperance, *supra* note 28, at 1157.

35. See *SEC v. National Sec. Inc.*, 393 U.S. 453 (1969) (noting that until the Court’s decision in *United States v. South-Eastern Underwriters*, 322 U.S. 533 (1944), it had been assumed based on *Paul v. Virginia*, 75 U.S. 168, 183-85 (1868), that “issuing a policy of insurance is not a transaction of commerce”).

36. 322 U.S. 533 (1944).

37. See *id.* at 553.

38. See *id.*

39. 15 U.S.C. § 1012 (1994).

40. See *id.* “Congress was mainly concerned with the relationship between insurance rate making and the antitrust laws and the power of the States to tax insurance companies.” *National Securities*, 393 U.S. at 458. Note, however, that in 1948, Congress expressly indicated that the McCarran-Ferguson Act was not a blanket anti-trust exemption for insurance entities. They expressly indicated that antitrust laws “shall be applicable to the business of insurance to the extent that such business is not regulated by [s]tate law.” 15 U.S.C. § 1012.

41. 15 U.S.C. § 1012.

B. *The OCC Expansion of Bank Insurance Powers*

Until the middle of the twentieth century, the respective industries focused on their primary functions. Eventually, however, banking interests looked to both section 24 (Seventh) and section 92 as sources for bank insurance powers. In the early 1960's, the Comptroller of the Currency, James Saxon, began to explore the possible expansion of banking activities.⁴² In 1962, the OCC issued an administrative ruling that allowed national banks to act as agents in the sale of insurance under the theory that the activity was incidental to the business of banking.⁴³ The ruling, however, was overturned by the United States Court of Appeals for the Fifth Circuit in *Saxon v. Georgia Ass'n of Independent Insurance Agents*⁴⁴ holding that section 24 (Seventh) is not a source of insurance powers for banks.⁴⁵

The OCC eventually continued its efforts to expand bank insurance activities, this time, however, focusing on the insurance powers of section 92.⁴⁶ Although previously viewed as a limited

42. See Lesperance, *supra* note 28, at 1151. In 1962, the Comptroller of the Currency, James Saxon, created a National Advisory Committee on Banking Regulatory Policies and Practices to investigate potential changes to the then-existing banking laws. The Committee recommended that national banks should be able to sell insurance. See *id.* (citing *Saxon v. Georgia Ass'n of Indep. Ins. Agents, Inc.*, 399 F.2d. 1010, 1012 (5th Cir. 1968)).

43. See *Saxon v. Georgia Ass'n of Independent Ins. Agents*, 399 F.2d 1010, 1012 (5th Cir. 1968). A bank is authorized by 12 U.S.C. § 24 (Seventh) to engage in any activities that are "incidental" to banking. See *supra* notes 26-30 and accompanying text. Although section 92 authorizes insurance agency activities, it is limited to banks operating out of small towns. See 12 U.S.C. § 92.

44. 399 F.2d. 1010 (5th Cir. 1968). In *Saxon v. GAIIA*, Citizens and Southern National Bank of Georgia (Citizens) applied for and received the OCC's permission to sell insurance from its Atlanta offices. See *id.* at 1011. The Georgia Independent Insurance Agents filed suit against Saxon, the Comptroller of the Currency, and Citizens. The Fifth Circuit upheld the district court's analysis that section 92 was the full extent of a bank's insurance power, and thus the OCC could not authorize Citizen's to sell insurance out of a town with greater than five thousand people. See *id.* at 1012. The Fifth Circuit's reasoning was based on the congressional intentions behind the enactment of section 92. See *id.* at 1016.

45. See *id.* at 1012.

46. See *infra* note 48 and accompanying text; see also OCC Interpretive Letter 623, State Law Restriction on National Bank Authority to Sell Annuities, [1993-1994] Fed. Banking L. Rep. (CCH) ¶ 83,505 (Sept. 24, 1993). The OCC ruled that a national bank can sell annuity products under the National Bank Act's incidental powers provision. See *id.*

bank insurance power, section 92, with a slight twist on interpretation, is now seen as the doorway allowing banks to enter the insurance arena.⁴⁷ In 1986, in response to a request by the National Bank of Oregon (NBO), the OCC issued an interpretative letter stating that national banks have the power under section 92 to sell insurance anywhere as long as the bank or branch is located in a small town.⁴⁸ As a result, the OCC permitted NBO to sell insurance nationally from Banks, Oregon--a town of less than five thousand.⁴⁹

The insurance industry, again threatened by the entry of banks into the once exclusive insurance market, began to look for ways in both the courts and the legislature to preclude national banks from playing in the insurance field.⁵⁰ The OCC's expansive interpretations prompted a series of suits by insurance interests.⁵¹ The efforts were, for the most part, unsuccessful.⁵² The defeats resulted, in part, from the Supreme Court's holding in *Chevron U.S.A., Inc. v. National Resources Defense Council, Inc.*⁵³ In *Chevron*, the Court indicated that it would afford increased judicial deference to the interpretations of less than clear statutory language by the administrative agency charged with enforcing the statute.⁵⁴ As a result, the OCC was given greater flexibility in more expansively interpreting both section 92 and section 24 (Seventh) to include bank insurance powers at least to the extent its interpretations are not contrary to the clear meaning of the statute.

47. In accordance with the decision in *Chevron U.S.A., Inc. v. National Resources Defense Council, Inc.*, 467 U.S. 837 (1984), the courts will now defer to the reasonable interpretation of the Comptroller. See *infra* note 53. Therefore, *Chevron* allows for an interpretation of section 92 that is more favorable to national banks. See *infra* notes 61-67 and accompanying text.

48. See OCC Interpretive Letter 366, National Bank May Sell Insurance to Customers Residing Outside Small town Where Its Main Office or Branch Is Located, [1985-1987 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,536 (Aug. 18, 1986). This ruling was based on the theory that section 92 does not address geographical limitations. See *id.*

49. See *id.* This ruling was challenged and upheld in *Independent Ins. Agents of Am. v. Ludwig*, 997 F.2d 958 (D.C. Cir. 1993). See *infra* note 55.

50. See *infra* notes 51-71 and accompanying text.

51. See, e.g., *Nationsbank v. Variable Annuity Life Ins. Co.*, 513 U.S. 251 (1995) (discussed *infra* notes 60-66 and accompanying text); *IIAA v. Ludwig*, 997 F.2d 958 (discussed *infra* notes 54-58 and accompanying text).

52. See *VALIC*, 513 U.S. 251; *IIAA v. Ludwig*, 997 F.2d 958.

53. 467 U.S. 837 (1984).

54. See *id.*

For example, in *Independent Insurance Agents of America, Inc. v. Ludwig*,⁵⁵ the United States Court of Appeals for the District of Columbia determined that in section 92 Congress did not address the issue of geographical limits on the insurance operations of national banks operating out of small towns.⁵⁶ Furthermore, the court held that the OCC's interpretation regarding the location of current and potential customers was reasonable in light of the ambiguity of the statute.⁵⁷ Thus, despite the protests of the insurance industry, and arguably original congressional intent,⁵⁸ the D.C. circuit held national banks could sell insurance to customers living outside of small towns.⁵⁹

This holding resulted in a significant blow to the insurance industry. Since the insurance industry is not represented by a federal agency, it is bound by the Comptroller's interpretation. Consequently, the insurance interests are concerned that the Comptroller's conclusions may not be impartial especially if the agency identifies with the industry it is charged with regulating.⁶⁰

55. 997 F.2d 958 (D.C. Cir. 1993). This suit was a challenge to the Comptroller's interpretative ruling regarding the insurance activities of the National Bank of Oregon. See *supra* note 48. Trade associations representing insurance agents and underwriters argued that the Comptroller exceeded his statutory authority. The district court granted summary judgment in favor of the Comptroller. See *National Ass'n of Underwriters v. Clarke*, 736 F. Supp. 1162 (D.C. Cir. 1990). The Court of Appeals for the District of Columbia Circuit reversed the district court on the grounds that Congress had repealed section 92, and thus there was no basis for the Comptroller's conclusions. The Court found that the 1952 edition of the U.S. Code omitted section 92 with a note indicating that Congress had repealed it in 1918. The provision was left out of each subsequent edition until 1994. See *Independent Ins. Agents of Am., Inc. v. Clarke*, 955 F.2d 731, 739 (D.C. Cir. 1992). The Supreme Court, however, pointing to clerical errors, found that section 92 had not been repealed despite its textual omission and remanded the case back to the Court of Appeals for the District of Columbia Circuit. See *United States Nat'l Bank v. Independent Ins. Agents of Am., Inc.*, 508 U.S. 439 (1993).

56. See *IIAA v. Ludwig*, 997 F.2d at 961.

57. See *id.*

58. See *supra* notes 28-33 and accompanying text.

59. See *id.* But see *Variable Annuity Life Co. v. Clarke*, 998 F.2d 1295 (5th Cir. 1993) (holding that section 92 precluded the Comptroller from permitting the sale of annuities by banks as incidental to banking). The Supreme Court ultimately resolved the conflict among the courts in *NationsBank* by overturning the 5th Circuit. See *infra* note 61.

60. See, e.g., *NationsBank v. Variable Annuity Life Ins. Co.*, 513 U.S. 251 (1995), (holding that contrary to insurance industry treatment and in accord with the Comptroller's interpretation, an annuity is not an insurance product).

In *NationsBank v. Variable Annuity Life Insurance Co. (VALIC)*,⁶¹ the Supreme Court confirmed the power of the OCC by affording it great judicial deference in the interpretation of what constitutes the business of banking pursuant to section 24 (Seventh).⁶² The Court ruled as reasonable the OCC's determination that the sale of annuities, a traditional insurance industry product, is incidental to the business of banking.⁶³ Thus, national banks can permissibly sell these annuities pursuant to section 24 (Seventh).⁶⁴

Furthermore, the Comptroller concluded that even though an annuity had been traditionally treated as an insurance product it was, in fact, a financial investment instrument.⁶⁵ Consequently, since the Comptroller did not consider annuities to be insurance, this activity was not considered within the reaches of the McCarran-Ferguson Act. Thus, banks may not be subject to the state regulatory requirements imposed on insurance companies selling the same product.⁶⁶ The OCC's determination that the annuity was not an insurance product, coupled with the Supreme Court's judicial deference to the agency's interpretation, enabled the banking industry to successfully engage in a traditional insurance activity. Furthermore, it "sent a message concerning the OCC's power to expansively interpret the National Bank Act."⁶⁷ It follows, therefore, that the Comptroller's seeming ability to unilaterally define

61. 513 U.S. 251 (1995).

62. *See id.* The Court expressly held that "the 'business of banking' is not limited to the enumerated powers in section 24 (Seventh) and that the Comptroller therefore has discretion to authorize activities beyond those specifically enumerated." *Id.* at 258 n.2.

63. *See id.* at 264 ("[w]e respect as reasonable the Comptroller's conclusion that brokerage of annuities is an 'incidental powe[r] . . . necessary to carry on the business of banking'").

64. *See id.*; *see also supra* notes 26-30 and accompanying text. Because annuities are not considered insurance, it is unclear whether section 24 (Seventh) would prove to be a source of power to engage in insurance activities or whether section 92 is the sole source of insurance powers for national banks. If the Comptroller were to determine that an insurance activity is incidental to banking as provided for under section 24 (Seventh), the activity may still be subject to the reverse preemption provisions of the McCarran-Ferguson Act because section 24 (Seventh) is not a federal statute that specifically relates to the business of insurance and thus subject to preemption by a conflicting state law.

65. *See VALIC*, 513 U.S. at 264.

66. *See id.* (holding that "we further defer to the Comptroller's reasonable determination that 12 U.S.C. § 92 is not implicated because annuities are not insurance within the meaning of that section").

67. Lesperance, *supra* note 28, at 1156.

insurance may enhance a national bank's ability to avoid restrictive state laws and thus gain a competitive advantage over insurers offering the same products.

At the same time it challenged the expansion of bank insurance powers in the courts, the insurance industry also pursued its defensive agenda in the state legislatures.⁶⁸ Many states, under the perceived authority of the McCarran-Ferguson Act, passed anti-affiliation statutes that essentially precluded or severely restricted banks from conducting insurance activities.⁶⁹ The passage of these statutes resulted in even more litigation; this time, however, it was instigated by banking interests.⁷⁰ Initially, the court rulings were split on whether section 92 could preempt state anti-affiliation laws in light of the McCarran-Ferguson Act;⁷¹ however, the OCC and banking interests prevailed.⁷²

In *Barnett Bank of Marion County, N.A. v. Nelson*,⁷³ the Supreme Court invalidated state anti-affiliation statutes that precluded a bank from selling insurance out of a town of less than five thousand.⁷⁴ In *Barnett*, a national bank located in Florida, was selling insurance from a small town pursuant to section 92, but in violation of a conflicting Florida statute. The Supreme Court reasoned that section 92 was a federal law that "specifically relates to

68. See Karol K. Sparks, *Towards Functional Regulation: Untangling Bank and Insurance Law*, in *THE NEW BUSINESS OF BANKING: WHAT BANKS CAN DO NOW*, at 595, 618 (PLI Corp. L. Practice Course Handbook Series No. B-912, 1995).

69. See *id.* at 606 & n.26. Anti-affiliation jurisdictions include Arizona, Arkansas, Colorado, Connecticut, Florida, Georgia, Illinois, Kentucky, Louisiana, Maine, Massachusetts, Mississippi, Nebraska, New Hampshire, New Mexico, New York, Pennsylvania, Rhode Island, Tennessee, Vermont, and West Virginia. See *id.* However, as a result of the *Barnett* decision, see *infra* note 73, many states are amending their anti-affiliation statutes.

70. See *infra* notes 72-75 and accompanying text.

71. See, e.g., *Owensboro Nat'l Bank v. Stephens*, 44 F.3d. 388 (6th Cir. 1994) (holding that the Kentucky anti-affiliation statute was enacted to regulate the business of banking, not insurance, and thus section 92 preempted the state statute); *Barnett Bank v. Gallagher*, 43 F.3d. 631 (11th Cir. 1995) (holding that section 92 did not specifically relate to the business of insurance, and therefore the state anti-affiliation statute, designed to protect policyholders, preempted section 92 under the McCarran-Ferguson Act), *rev'd sub nom.*, *Barnett Bank v. Nelson*, 517 U.S. 25 (1996).

72. See *infra* notes 73-76 and accompanying text.

73. 517 U.S. 25 (1996).

74. See *id.* at 26.

the business of insurance" and thus is exempt from the McCarran-Ferguson reverse preemption rule.⁷⁵ The Court found that the state law prohibiting the bank from selling insurance was invalid in the face of section 92.⁷⁶

As banks expand their insurance powers, the applicability of state insurance laws becomes an issue. *Barnett* helps to clarify the extent to which state laws regulating insurance will be preempted by section 92.⁷⁷ If the state law prevents or significantly impairs a national banks' insurance powers under section 92, either by treating banks differently than other insurance sellers or by applying the state laws in such a manner to have a disparate impact, then it will be invalid.⁷⁸

The OCC has issued guidelines to national banks regarding insurance and annuity sales.⁷⁹ The guidelines indicate that "a state law that applies generally to regulate insurance agents and agencies will apply to national banks provided the law does not effectively prevent national banks from conducting activities authorized under federal law."⁸⁰ The OCC acknowledges that the Court in *Barnett* indicated that their decision did not "deprive [s]tates of the power to regulate national banks where . . . doing so does not prevent or significantly interfere with the national bank's exercise of its powers."⁸¹ Interestingly, however, the OCC defines "significantly interferes" as anything other than "in an insignificant way."⁸² The guidelines essentially indicate that bank insurance sales will be

75. See *id.* (citing 15 U.S.C. § 1012 (1994)); see also *supra* notes 40-41 and accompanying text.

76. See 15 U.S.C. § 1012 (1994). Julie Williams, Chief Counsel of the OCC, noted that:

Barnett makes clear that a class of laws preventing national banks from engaging in insurance sales under section 92 are preempted by federal law. At the next level are those state laws that do not prevent, but do impact or limit in some way, the ability of national banks to exercise their insurance powers.

Julie L. Williams et al., *After Barnett: The Intersection of National Bank Insurance Powers and State Regulation*, 1 N.C. BANKING INST. 13, 35 (1997).

77. See *Barnett*, 517 U.S. 25.

78. See Williams et al., *supra* note 76, at 35.

79. See OCC Advisory Letter 96-8, *supra* note 16.

80. *Id.* at 35, 756.

81. *Id.*

82. *Id.*

regulated by the states; however, the OCC will retain preemptory ability.

C. *The OCC's Expansive Powers*

The Supreme Court's unanimous decisions in *VALIC* and *Barnett* provided support for the authority of the OCC to expand national bank insurance powers.⁸³ As a result, the current Comptroller of the Currency, Eugene A. Ludwig, began to issue new opinions and regulations increasing national banks' foothold in the insurance markets.⁸⁴ In November 1996, the OCC issued an interpretive letter to First Union Corporation in which it ruled that section 92 did not geographically restrict the bank to selling insurance within the small town.⁸⁵ The OCC declared that as long as a bona fide bank or branch was located in a town of less than five thousand persons, a bank could sell to customers anywhere.⁸⁶ At least one district court, deferring to the reasonable interpretation of the Comptroller, has upheld the interpretation.⁸⁷ This ruling, coupled with the *Barnett* decision, essentially allows a national bank with a small town branch to sell insurance without a geographical limitation and notwithstanding state insurance statutes to the contrary.⁸⁸

83. See *supra* notes 61-76 and accompanying text.

84. See *infra* notes 85-95 and accompanying text.

85. See OCC Interpretive Letter 753, Establishment of Operating Subsidiaries to Engage in Insurance Agency Activities, [1996-97 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81-107 (Nov. 4, 1996) [hereinafter OCC Interpretive Letter 753]. The OCC had earlier determined that section 92 did not geographically restrict the bank to customers within the small town. See OCC Interpretive Letter 366, *supra* note 48; *supra* note 48 and accompanying text. The interpretive letter to First Union further indicated that the marketing activities of the bank or branch were not limited to the small town and could be conducted out of other locations by agents. First Union, however, would manage all activities and agents out of the small town office. See OCC Interpretive Letter 753, *supra*.

86. See OCC Interpretive Letter 753, *supra* note 85.

87. See *Shawmut Bank Connecticut, N.A. v. Googins*, 965 F. Supp. 304 (D. Conn. 1997).

88. See generally Ronald R. Glancz et al., *Bank Insurance Sales Spark Regulatory Rumbles*, NAT'L L.J., Sept. 8, 1997, at C2. The *Barnett* decision did not address whether section 92 imposed geographical limitations. Thus, OCC Interpretive Letter 753 allows banks to sell annuities beyond the small town's borders.

In addition to finding insurance agency powers in section 92 and section 24 (Seventh), the OCC has also taken other action to open the door for underwriting of insurance by banks.⁸⁹ The OCC revised its corporate activities regulation and enacted the Operating Subsidiary rule effective December 31, 1996.⁹⁰ Under the rule, certain well-managed, well-capitalized banks may apply to have a subsidiary engage in activities that are part of the business of banking or incidental to banking, but that are not necessarily permissible for the bank itself.⁹¹ As a result, a national bank may potentially look to an operating subsidiary to conduct insurance underwriting activities.⁹²

For example, in May 1997, the OCC approved Banc One's proposal to establish an operating subsidiary to reinsure a portion of the mortgage insurance on their loans.⁹³ Reinsurance is an insurance activity with some of the benefits and most of the risks of direct underwriting.⁹⁴ Insurance interests fear these decisions will allow an avenue for insurance underwriting by national banks.⁹⁵

89. See *infra* notes 83-88 and accompanying text.

90. See 12 C.F.R. § 5.34 (1997).

91. See generally William T. McCuiston, *National Bank Operating Subsidiaries: How Far Has the OCC Opened the Door to Nonbanking Activities?*, 2 N.C. BANKING INST. 264 (1998) (discussing applications under the new Part 5 regulations); see also Glancz et al., *supra* note 88, at C2.

92. See Glancz, *supra* note 88, at C2.

93. See OCC Corporate Decision 97-27, Notification by Banc One, Columbus, N.A., Columbus, Ohio, of its Intent to Establish an Operating Subsidiary to Reinsure mortgage Insurance (May 2, 1997), available in 1997 WL 272587.

94. Reinsurance is the assumption of all or part of a risk originally undertaken by an insurer. "It binds the reinsurer to pay to the reinsured the whole loss sustained in respect to the subject of the insurance to the extent to which he is reinsured." BLACK'S LAW DICTIONARY 1287 (6th ed. 1990). Although the reinsurer, in this case the bank, is not the primary contact with the insured, they will receive the premium and pay out any losses associated with the risk that was assumed. See *Once Invincible Ludwig is Put on the Defense*, BEST's INS. NEWS, May 5, 1997, available in 1997 WL 7077807. Banks face great risk with reinsuring or underwriting its own mortgages. See *id.* ("One need only consider the millions of dollars in damage generated by Hurricane Andrew to understand that a tremendous risk of loss attaches to mortgage insurance.") (quoting Barbara Synder, Vice President for Financial Reporting, National Academy of Actuaries).

95. See, e.g., Duran, *supra* note 3, at 4 (noting that the operating subsidiary rule does not specifically raise the issue of whether a subsidiary could engage in insurance activities, but that it does give the OCC the authority to decide what activities the subsidiary can engage in, including insurance).

III. INDUSTRY REACTION AND CONCERNS

The sweeping Supreme Court decisions⁹⁶ and the OCC's continued aggressive position, have prompted several political and legislative changes.⁹⁷ For the past 100 years, the insurance industry has opposed bank entry into the insurance business.⁹⁸ The insurance interests feared that banks will enjoy unfair competitive advantages.⁹⁹ The insurance industry reasoned that since national banks are regulated federally, they may not necessarily be playing by the same rules as insurers who are subject to varying state regulations regarding capital¹⁰⁰ and licensing requirements.¹⁰¹ In addition, the insurance industry expressed concern that consumer protection safeguards would deteriorate if banks, regulated under the current institutional scheme, were allowed to conduct insurance activities.¹⁰²

However, as a result of the above-mentioned Supreme Court decisions, administrative rulings, and changing market forces, the

96. See *supra* notes 53-88 and accompanying text.

97. See *supra* notes 42-95 and accompanying text.

98. See Clayton, *supra* note 3 (quoting Paul Equale, Senior Vice President of Government Affairs, IIAA).

99. See Duran, *supra* note 3, at 4 ("Convinced that expanded bank insurance powers would give banks an unfair competitive advantage, both life and property/casualty agency associations have vigorously opposed further bank entry into insurance.").

100. See *Kentucky Official Seeks Respect for State Regulators*, BEST's INS. NEWS, July 21, 1997, available in 1997 WL 7078313. George Nichols III, Kentucky Commissioner of Insurance, in testimony before the House Commerce Committee on July 17, 1997, noted that "since the Federal Reserve would set capital requirements . . . this would impinge on the ability of state insurance regulators to ensure proper capital standards for entities that underwrite insurance products." *Id.*

101. See Sparks, *supra* note 68, at 618 ("The Comptroller has claimed preemption not only of the licensing of banks, but of the licensing of bank employees as well.") (referring to OCC Interpretive Letter 623, *supra* note 46, and OCC Interpretive Letter 475).

102. See *id.* at 497 ("The Comptroller appears to recognize the massive undertaking it would assume if it should disenfranchise states from national bank insurance powers. It generally admits the valid role of state laws as a matter of sound business practices."). Other consumer protection concerns commonly identified include: consumer perception that products are federally insured; credit that is contingent on the purchase of insurance products; the actual illegal tying of products; and the non-application of state licensing requirements. See generally *Consumers Fear and are Confused by Banks Selling Insurance—IIAA Survey*, 1997 INS. INDUS. LITIG. REP. (ANDREWS) 22327 (July 2, 1997) [hereinafter *IIAA Survey*] (citing a national survey conducted by International Communications Research, Media, Pennsylvania, released June 9, 1997 by the Independent Insurance Agents Association).

insurance industry has fundamentally changed its policy and now supports bank and insurer affiliations.¹⁰³ Politically, insurance interests are no longer trying to keep the two industries separated, rather are now focusing on the advantages that the respective industries can offer each other.¹⁰⁴ In addition, several states have enacted statutes or issued guidelines that allow bank and insurer affiliations.¹⁰⁵ These changes have created the opportunity for both industries to work toward a common goal.

The events that led up to the present environment have created an ideal, perhaps even critical, opportunity for substantial financial reform.¹⁰⁶ Fueled by the *VALIC* and *Barnett* decisions and the subsequent about-face by the insurance industry, financial reform has gained new life.¹⁰⁷ For the first time, insurers are willing to sit down at the table in an atmosphere of compromise.¹⁰⁸ They are resigned to the inevitable entry of banks into the insurance market and are cooperating in hopes to ensure that new legislation is fair.¹⁰⁹

103. See Anderson, *supra* note 6; Yonan, *supra* note 8; *Insurance Agents to end Turf War with Banks*, *supra* note 6.

104. For a discussion of the advantages banks offer, see Duran, *supra* note 3, at 5. These advantages include the banks' existing network of offices and branches in virtually every neighborhood, comprehensive customer databases for both individual and business clients, banks' strength in leveraging technology to more efficiently reach customers, and higher consumer confidence and trust. See *id.*

105. As a result of the *Barnett* decision, Florida amended its anti-affiliation statute so that any bank located in a city of 5000 or less could sell insurance. See FLA. STAT. ANN. § 626.988 (West Supp. 1998); see also CONN. GEN. STAT. ANN. § 36a-250(38) (West 1996) (allowing banks to sell fixed and variable annuities); Letter from Dwight K. Bartlett, III, Maryland Insurance Commission, and H. Robert Hergenroeder, Maryland Commissioner of Financial Regulation, to Maryland Bankers (Oct. 31, 1996) (discussing the guidelines for the sale of insurance by banks in Maryland) (on file with *The Business Lawyer*, University of Maryland School of Law); Elton Bomer, Texas Commissioner of Insurance, Texas Commissioner's Bull. No. B-0043-96, Interim Procedures for Banks Selling Insurance (June 20, 1996), available in WESTLAW, TX Bulletin B-0043-96 (allowing national and state chartered banks located in towns of 5000 or fewer people to be licensed to sell insurance).

106. See *supra* notes 42-95 and accompanying text.

107. Significant financial modernization bills were proposed at the opening of the 105th Congress in the wake of the *Barnett* decision. House Banking Committee Chair Jim Leach (R-IA) introduced H.R. 10, the Financial Modernization Act of 1997, providing for bank and insurer affiliations. See *infra* notes 117-82 and accompanying text (discussing H.R. 10). In addition, Representative Marge Roukema (R-NJ) introduced a separate bill, H.R. 1306, the Depository Institution Affiliation and Thrift Charter Conversion Act, that would allow affiliations between financial services firms and commercial firms.

108. See *supra* notes 97-104 and accompanying text.

109. See, e.g., Anderson, *supra* note 6.

Many insurers are also eager about the opportunity to engage in traditional banking activities.¹¹⁰ On the other hand, banks who have until now enjoyed an expansion of their insurance powers should be alert to legislators who are concerned with the implications for consumers and other industries if the administrative agency policy making continues unchecked.¹¹¹ These changes have removed a key stumbling block to financial services reform--insurance industry resistance.¹¹²

Despite the change in attitude, however, insurance interests are likely to continue fighting for legislation that addresses their two primary concerns: fair competition through functional regulation and consumer protection through the preservation of the state regulatory scheme.¹¹³ Likewise, national banks will push for expanded insurance powers that are not impeded by what they consider to be discriminatory state insurance laws.

110. As an example, in June 1997 State Farm Mutual Automobile Insurance Co. filed an application for a federal savings bank charter with the Office of Thrift Supervision and applied to the Federal Deposit Insurance Corporation for deposit insurance coverage. See *Insurers Fear Threats to Federal Thrift Charter*, BEST's INS. NEWS, July 28, 1997, available in 1997 WL 7078358. It is important to note that Robert R. Davis, Director of Government Relations for the America's Community Bankers, noted in a letter to the Commerce Committee Chairman, Thomas J. Bliley (R-VA) that "unitary thrift holding companies 'follow strict functional regulation principles.'" *Id.* In August 1997, the National Association of Mutual Insurance Companies submitted a similar application to establish a bank to provide financial services for its member insurers to sell. See *NAMIC to Start Thrift to Serve Its Member Insurers*, BEST's INS. NEWS, Aug. 20, 1997, available in 1997 WL 7078541. Securities firms such as Principal Financial Group, Travelers Group, Inc. and Merrill Lynch & Co. have made similar applications. See *id.*

111. Senator Alfonse D'Amato (R-NY), Chairman of the Senate Banking Committee, accused Comptroller of the Currency Eugene Ludwig of undermining the solvency of the federal deposit insurance fund. *Once Invincible Ludwig is Put on the Defensive*, *supra* note 94 ("Above all, I am deeply troubled and concerned that the Comptroller of the Currency's aggressive actions may, once again, subject federally insured banks to excessive insurance risks and expose the bank insurance funds, and therefore taxpayers, to unnecessary liability.") (quoting Senator D'Amato). Furthermore, Representative John Dingell (D-MI), publicly called for Ludwig's ouster. A top aide for Dingell is quoted as saying, "[w]e're still trying to get rid of Ludwig." *Id.*

112. See Clayton, *supra* note 3.

113. See Yonan, *supra* note 8.

IV. FINANCIAL SERVICES REFORM

The time is right and the stage is set for both the banking and insurance industries to compromise and move forward. In implementing financial reform, Congress should repeal section 92 of the National Bank Act as unnecessary and replace it with legislation that would allow nondiscriminatory access for both insurers and banks wishing to enter other financial services markets.¹¹⁴ It has been proposed that this legislation should be enacted under a functional regulatory scheme to ensure: (1) competitive equality, (2) regulatory efficiency and effectiveness, and (3) adequate consumer protection.¹¹⁵

A. Repealing Section 92

Regardless of whether it is currently interpreted by the courts and regulatory authorities in accordance with original congressional intent,¹¹⁶ section 92 has created ambiguity regarding the extent of bank insurance powers.¹¹⁷ Furthermore, a national bank's ability to sell insurance to consumers nationally and to conduct the related marketing activities from anywhere¹¹⁸ essentially makes the section 92 small town requirement unnecessary. There is no need to require a national bank to operate out of a small town branch as a mere formality to nationalized insurance sales. If banks are generally permitted to sell insurance, then small town banks would also have the opportunity to boost profits through these activities.

114. See *infra* notes 116-22 and accompanying text.

115. See *infra* notes 141-79 and accompanying text.

116. See *supra* notes 28-33 and accompanying text.

117. According to some, the resulting interpretations have created conflict and uncertainty regarding the boundaries of state and federal laws, as well as the appropriate limits of state and federal regulatory prerogatives. See, e.g., *Financial Services Restructuring: Hearings Before the Subcommittee on Finance and Hazardous Materials of the Committee of Commerce*, 105th Cong. 27-32 (1997) [hereinafter *Financial Services Restructuring Hearings*] (statement of Mark Pope, Vice President and Director of Federal Governmental Relations, Lincoln National Corporation). Pope was expressing his frustration with the recent regulatory rulings of the OCC. See *id.*

118. Advances in modern technology, certainly not contemplated by Congress in 1916, have created a significant loophole for the expansion of banks into insurance activities. See Sparks, *supra* note 68, at 604 (citing the court's acknowledgment of technology changes in *Independent Ins. Agents of Am., Inc. v. Ludwig*, 997 F.2d 958 (D.C. Cir. 1993)).

Consequently, clarification and reevaluation of congressional intent is needed and must come from the legislative branch.¹¹⁹ Section 92 should be repealed and replaced with more specific language in a comprehensive financial reform package. In the pursuit of reform, national banks will seek legislation that ensures their ability to engage in insurance activities. The insurance industry will try to ensure that competitive equality is inherent in any change. Finally, those representing the interests of policyholders and depositors will want to ensure an effective and efficient regulatory scheme. Legislation that clearly defines the rules and encourages financial services affiliations will not only serve the interests of both the banking and insurance industries, but the general public as well.¹²⁰ In addition, financial services reform will promote efficiency in the financial markets¹²¹ and create incentives for the development of new and innovative products.¹²²

119. See *Independent Ins. Agents of Am. v. Ludwig*, 997 F.2d 958, 961 (D.C. Cir. 1993) (noting that "when time and technology open up a loophole, it is up to Congress to decide whether it should be plugged, and how").

120. Of concern to those in the banking industry are the state anti-affiliation laws that restrict or limit a bank's access to insurance markets. See Collins, *supra* note 116, at 6. The insurance industry, on the other hand, is concerned with the competitive inequality among all players in the financial services arena that may result if different regulations are imposed for similar transactions or if the same regulations are applied inconsistently by different regulators. See Melanie L. Fein, *Functional Regulation: A Concept For Glass-Steagall Reform*, 2 STAN. J. L. BUS. & FIN. 89, 90 (1995). Legislators are eager to increase the efficiency of the financial markets while maintaining the integrity of consumer protection laws. Reform that removes the roadblock for financial services affiliations while implementing a true functional regulatory scheme will alleviate these concerns. See *infra* notes 123-79 and accompanying text.

121. See *infra* notes 156-71 and accompanying text; see also Rubin *Offers Blueprint for Financial Reform; Details Coming Soon*, BANKING POL'Y REP., June 2, 1997, available in LEXIS, BANKNG Library, BNKPOL File. Treasury Secretary Robert E. Rubin in a speech to the Exchequer Club of Washington noted that "if increased competition from financial modernization were to reduce costs to consumers by 1%, that would be a savings of about \$3 billion a year." *Id.* at 3. Rubin believes the savings could be as high as 5%. See *id.* "The bulk of these savings should come as financial services firms, driven by increased competition, adopt best-practices." *Id.*

122. See Pamela Atkins, *Financial Services Reform: D'Amato, Baker Introduce Modernization Bill Permitting Merger of Banking, Commerce*, 68 Banking Rep. (BNA) 297, 297 (1997) ("my goal in financial modernization is to craft a bill broad enough to benefit American consumers by improving competition, making more services available, and allowing more rapid technological innovation in the marketplace") (quoting Representative Richard Baker (R-LA)).

B. *Functional Regulation*

Various legislators and many in the insurance industry have advanced a functional regulatory scheme as necessary to achieve successful financial reform and to promote the interests of all parties.¹²³ This would mean that federal regulators would oversee banking activities while state insurance regulators would oversee the insurance functions.¹²⁴ Proponents of functional regulation indicate it will ensure competitive equality, regulatory efficiency and effectiveness, and adequate consumer protection measures.¹²⁵ National banks, however, fear that a state regulatory scheme could result in discriminatory statutes that impair their ability to conduct insurance activities.¹²⁶ This concern may be alleviated, however, if financial reform legislation includes provisions which limit the federal preemptory ability of any state statute that is facially or actually discriminatory.¹²⁷

123. For example, the House Commerce Committee version of H.R. 10, the Financial Services Act of 1997, proposes that any bank insurance activities operate under a functional regulatory scheme. *See infra* note 127 discussing H.R. 10; *see also* Yonan, *supra* note 8 (IIAA supports financial affiliations as long as a functional regulatory system is used.).

124. *See infra* notes 128-40.

125. *See* Fein, *supra* note 120, at 90.

126. *See* J. Virgil Mattingly & Kieran J. Fallon, *Understanding the Issues Raised by Financial Modernization*, 2 N.C. BANKING INST. 25 (1998) (noting that "full functional regulation of bank insurance activities by state insurance supervisors could permit certain states to adopt onerous regulation designed effectively to prohibit banks from conducting insurance activities"); *see generally* Kathleen W. Collins, *Dysfunctional Regulation: Oh, What a Tangled Web*, BANK INS. MARKETING, Spring 1997, at 6. In the wake of the *Barnett* ruling, which allowed insurance companies to sell annuities from small towns, several states enacted discriminatory legislation "under the guise of consumer protection." *Id.*; *see also supra* notes 73-76 and accompanying text (discussing *Barnett*). For example, Rhode Island enacted a statute, 1996 R.I. Pub. Laws 325 (to be codified in scattered sections of R.I. GEN. LAWS § 27), which includes advance and post-sale disclosures, physical separation of bank and insurance sales activities, non-use of customer information, no discounts, and no packaging of products.

127. For example, on January 7, 1997, Representative James Leach (R-Iowa) introduced H.R. 10, the Financial Services Competition Act of 1997. Different versions of the bill were passed by the House Committee on Banking and Financial Services and the House Committee on Commerce in June 1997 and October 1997, respectively. *See* Financial Services Competition Act of 1997, in H.R. 10, H.R. REP. NO. 105-164, pt. 1 (1997) [hereinafter Banking Report]; Financial Services Act of 1997, in H.R. REP. NO. 105-164, pt. 3 (1997) [hereinafter Commerce Report]; *see also infra* notes 180-92 and accompanying text (discussing pertinent provisions of H.R. 10). The Commerce Committee version calls for functional regulation of insurance sales and at the same time, prohibits states from

Under functional regulation, as opposed to the current entity regulation, each product should be regulated based on its function, rather than on who is selling it to the public.¹²⁸ In other words, similar products or services are regulated by the same governmental entity. In terms of insurance and banking, this regulatory scheme would mean that state insurance regulators would oversee all insurance activities, including bank insurance activities, while the OCC and the Federal Reserve would oversee any banking related activities regardless of the entity.¹²⁹

Because entities will now be crossing industry lines, an oversight agency is needed to coordinate the efforts of the regulators. Furthermore, a mechanism should be in place for dispute resolution.¹³⁰ If bank and insurance affiliations are permitted through bank holding company subsidiaries, the Federal Reserve has stressed the importance of a single umbrella agency, such as itself, that will oversee the holding company parent and have preemptory rights over all of the other regulators.¹³¹ The Federal Reserve argues that oversight of the consolidated entity will make it easier to identify problems that effect the whole bank holding company organization.¹³²

preventing or restricting a national bank from engaging in any activity permitted by the bill. See Commerce Report, *supra*, at §§ 104, 302-03.

128. See *Once Invincible Ludwig is put on the Defensive*, *supra* note 94.

129. See *Rubin Offers Blueprint for Financial Reform; Details Coming Soon*, *supra* note 121, at 2.

130. For example, currently the OCC has broad authority to determine what is considered the business of banking. The Supreme Court has indicated that the OCC should be afforded great deference in determining what constitutes the business of banking, including defining which products are, in fact, banking products. See *NationsBank*, 513 U.S. 251 (where annuities were determined by the OCC to be an investment product, not an insurance product, despite the fact that most states defined and regulated them as such).

131. See Steven Brostoff, *Volcker Wants Banks, Commerce Kept Apart*, *BEST's INS. NEWS*, May 19, 1997, available in 1997 WL 9331733. The Federal Reserve Board believes that umbrella regulation is unavoidable. See *id.* ("The overriding and distinctively federal interest in safety and soundness requires that some authority, armed with adequate authority be charged with broad oversight and surveillance over the entire holding company.") (quoting Paul A. Volker, Chairman, Federal Reserve Board).

132. See Mattingly & Fallon, *supra* note 126 ("Umbrella supervision provides the federal supervisory agencies with the ability to identify problems within the organization as a whole, or at an affiliate of an insured bank . . . and to develop strategies to protect the insured bank *before* significant harm occurs.").

Many in the financial services industries, however, dispute the need for an overarching regulator.¹³³ These individuals reason that functional regulation still allows federal regulators the ability to ensure the safety and soundness of the subsidiary banks; therefore, a supervisory bank regulator overseeing the consolidated entity is not necessary.¹³⁴ Their concern is that a federal regulator will result in "duplicative, costly, and burdensome regulations" for nonbank subsidiaries overseen by other regulatory agencies.¹³⁵ Furthermore, opponents to umbrella regulation argue that a supervisory federal banking regulator with preemptory ability may be in the position of imposing capital, reporting, or examining requirements that could significantly interfere with the operations of a nonbanking subsidiary in order to ensure the safety and soundness of the banking subsidiaries.¹³⁶

Another concern in the functional regulation framework is determining which transactions belong to which regulators. For instance, in *VALIC*, the issue was whether or not annuities were insurance.¹³⁷ Since the Court held that annuities were not insurance, they were no longer subject solely to state regulatory authority. Some envision a neutral agency consisting of various representatives from the different industries who will resolve the issues over the definition of insurance and other similar disputes.¹³⁸ Others, however, see this agency as an unnecessary layer of regulatory authority and instead urge that any disputes that arise between regulators be settled not by the agency, but by the courts.¹³⁹

133. See *Insurers, Banks Seek Harmony on Affiliation Details*, BEST's INS. NEWS, Feb. 18, 1997, available in 1997 WL 7077347. Weller Meyer, Chief Executive Officer of Acacia Federal Savings Bank, argued before the House Banking Subcommittee on Financial Institutions and Consumer Credit that "no overarching federal regulator is needed." *Id.* Meyers was criticizing a bill by Banking Committee Chairman, James Leach, that would set up new bank holding companies regulated by the Federal Reserve. See *id.*; see also *infra* note 139.

134. See *Insurers, Banks Seek Harmony on Affiliation Details*, *supra* note 133.

135. See Mattingly & Fallon, *supra* note 126.

136. See *id.* In the case of insurance, a federal banking regulator may be in the awkward position of sacrificing policyholder interests for those of depositors.

137. See *Nationsbank v. Variable Annuity Life Ins. Co.*, 513 U.S. 251; see also *supra* notes 61-66 and accompanying text.

138. See, e.g., Banking Report, *supra* note 127, at § 121. The Banking Committee's version of H.R. 10 establishes a ten-member interagency council to resolve banking-insurance disputes arising under the National Bank Act. See *id.*

139. For example, L. Gerald Roach, President of Mutual Assurance Society of Virginia

Although there are some pros and cons to each method, either would ultimately serve to promote the key benefits of functional regulation. These benefits include: 1) competitive equality, 2) regulatory efficiency and effectiveness, and 3) consumer protection.¹⁴⁰

1. Competitive Equality

A key concern for those in the insurance industry is the ability to compete on a level playing field.¹⁴¹ Proponents of functional regulation argue that under true functional regulation, entities engaged in similar transactions and products are subject to the same rules interpreted and administered consistently by the same regulators. As a result, regulatory advantages will not be afforded different entities competing in the same transactions. Proponents of entity regulation, however, suggest that the agency responsible for the entity can adequately administer the appropriate rules and regulations for the various transactions in which the entity may engage.¹⁴² This proposal, however, ignores the potential for inconsistent application of the rules and regulations by various regulators operating under different motives and philosophies. Furthermore, it shows the lack of appreciation for the complex transactions and unique risks involved in those transactions that

and Chairman of the National Association of Mutual Insurance Companies, argued before the Commerce Subcommittee on Finance and Hazardous Materials that an extra layer of regulators is "too bureaucratic" and would be an inefficient way of solving disputes among regulators. See *Insurers Fear Threats to Federal Thrift Charter*, *supra* note 110. Roach would instead propose an expedited federal court system where disputes would be reviewed *de novo*, as opposed to providing deference to federal regulators under the *Chevron* standard, within a 90 day period. See *id.*; see also Commerce Report, *supra* note 127, at § 307 (providing for expedited judicial review with conflicts resolved "based on [the court's] review of the merits . . . without unequal deference").

140. See Fein, *supra* note 120, at 90.

141. See, e.g., *ACLI Chief Sees Continued Bank-Insurance Conflict*, *supra* note 11 (noting that Carroll Campbell, Jr., President and Chief Executive Officer of the American Council of Life Insurance, "stressed the importance of a level playing field for banks . . . and insurers by requiring them to play by the same rules when it comes to regulations").

142. For example, with reference to securities regulation, opponents of entity regulation argue that it would be "inefficient for the SEC to hire and train hundreds of new SEC examiners to perform an oversight function that existing federal bank examiners can easily be trained to perform." Fein, *supra* note 120, at 107.

would require more than a simple training session taught by those with inadequate experience in the particular industry.

Those in favor of functional regulation indicate that it will also play an important role in ensuring the diversification of economic power.¹⁴³ Some are concerned that allowing financial services entities to affiliate will result in the concentration of economic power in a few super financial institutions.¹⁴⁴ This concentration may result in a vulnerable consumer with fewer choices.¹⁴⁵ In order for the smaller financial entity to survive, proponents of functional regulation suggest that it will afford those entities that choose not to affiliate the ability to effectively compete.¹⁴⁶ If, regardless of the entity, similar transactions are subject to the same regulations imposed by the same regulators, then an organization will not be compelled to affiliate in order to gain regulatory advantages.¹⁴⁷

Many banking interests oppose functional regulation. If insurance transactions continue to be regulated by the various states, banks fear that local state statutes will be enacted that discriminate against banks.¹⁴⁸ Consequently, they argue that OCC authority to preempt state statutes is necessary to protect the bank's interests.

143. See *infra* notes 144-47 and accompanying text.

144. For example, former Federal Reserve Board Chairman, Paul A. Volcker, commenting on bank and commercial affiliations explained that the United States "has always had a strong aversion to massive concentrations of economic power." Brostoff, *supra* note 131. This same sentiment was expressed in 1995 by the IIAA and the Independent Bankers during their effort to stop financial services reform that included affiliations. Robert Rusbuldt, Vice President of Federal Affairs for IIAA said "[we] believe that free markets work, but that free markets do not truly exist in financial services, and I believe there is a fundamental distrust of huge corporations." Mark A. Hofmann, *Alliance; Independent Bankers and Agents Join Forces to Prevent Ventures between Banks and Insurers*, BUS. INS., Nov. 6, 1995, available in 1995 WL 7498111. Ron Ence, Director of Legislative Affairs for IB voiced this same sentiment when he stated that, "We do not believe that financial concentration is good." *Id.*

145. For example, Robert Rusbuldt believes that concentration of credit would mean fewer sources of credit for small business owners. See Brostoff, *supra* note 131.

146. See *Financial Services Restructuring Hearings*, *supra* note 117, at 28 (statement of Mark Pope, Vice President and Director of Federal Government Relations, Lincoln National Corporation).

147. See *id.* at 28-29. "Only in this way will there be assurance that the benefits and burdens of regulation fall equally on the stand-alone company and on the company in the same business that chooses to affiliate." *Id.* at 28.

148. See *supra* note 126.

One way to alleviate these fears, however, is to prohibit any state law that prevents or restricts bank insurance activities.¹⁴⁹

In addition, although currently there seems little incentive for banks to level the playing field due to recent regulatory rulings that are favorable to banks, this advantage may be short lived.¹⁵⁰ For example, insurers like State Farm are not waiting for financial reform to open the door to financial service affiliations.¹⁵¹ Instead they are seeking to engage in banking activities through the unitary thrift holding company structure by obtaining a federal savings association charter issued by the Office of Thrift Supervision.¹⁵² A unitary thrift holding company may engage in any activity, including insurance, so long as the sole thrift owned by the holding company meets the qualified thrift lender test.¹⁵³ Bankers are now crying foul; they claim that insurance companies have found a backdoor into the banking business thereby creating an unfair competitive environment.¹⁵⁴ Accordingly, functional regulation ensures that all those who are selling insurance products and those involved in banking activities are playing by the same rules.¹⁵⁵

149. States are prohibited from preventing or restricting a bank from engaging directly or indirectly in any activity permitted by the bills. *See* Banking Report, *supra* note 127, at § 104; Commerce Report, *supra* note 127, at § 104. Each version of H.R. 10 allows for insurance agency sales by a national bank and its subsidiaries. *See* Banking Report, *supra* note 127, at § 141; Commerce Report, *supra* note 127, at § 121.

150. *See supra* note 111 and accompanying text.

151. *See supra* note 110 and accompanying text.

152. Both the Financial Services Competition Act of 1997 and the Financial Services Act of 1997 propose to eliminate the Office of Thrift Supervision by merging it with the OCC; however, those currently engaged in activities under this structure may be able to continue through grandfathered provisions. *See* Banking Report, *supra* note 127, at § 316; Commerce Report, *supra* note 127, at § 316.

153. *See* 12 U.S.C. § 1467a(c)(3)(A) (1994). To be a qualified thrift lender, the thrift must have 65% or more of its assets in qualified thrift investments. *See id.* § 1467a(m).

154. *See Insurers Fear Threats to Federal Thrift Charter, supra* note 110 (citing position held by the American Bankers Association regarding insurers such as State Farm that have applied for thrift charters). Bankers are concerned that the unitary thrift holding companies will allow an "unrestricted mix of commerce and banking" resulting in unfair advantages for these insurers. *Id.*

155. *See ACLI Chief Sees Continued Bank-Insurance Conflict, supra* note 11 (citing Carroll Campbell Jr., President and Chief Executive Officer of the American Council of Life Insurance).

2. Regulatory Efficiency and Effectiveness

Proponents of functional regulation argue that it would promote regulatory efficiency by reducing conflict, duplication, and overlap of the regulatory function.¹⁵⁶ Meanwhile, the current regulatory scheme has produced confusion and uncertainty resulting in never ending court battles.¹⁵⁷ Much time and money is spent in legal disputes as the two industries clash in an uncertain regulatory environment. However, under a functional regulatory scheme, regardless of the regulatory agency that ultimately oversees a certain financial product, the product will be regulated the same. As a result, the potential for confusion and conflict will be greatly reduced by clarifying the regulator's jurisdictional line.¹⁵⁸ Proponents of functional regulation argue that clearly drawn lines will eliminate the uncertainty that can hinder effective strategic planning and stifle development and marketing of innovative products that could benefit business and consumers.¹⁵⁹

Opponents of functional regulation argue that an entity engaged in various financial services activities would be dealing with several different regulators.¹⁶⁰ Because an entity may have to report to numerous regulators, this may result in additional costs.¹⁶¹ These expenses, however, are already incurred by the respective industries and thus serves only to level the playing field.¹⁶² The consumer

156. See Fein, *supra* note 120, at 92.

157. See, e.g., *Barnett Bank v. Nelson*, 517 U.S. 25 (1996) (discussed *supra* note 73); *Nationsbank v. Variable Annuity Life Ins. Co.*, 513 U.S. 251 (1995) (discussed *supra* note 60); *Texas Bankers Ass'n v. Bomer*, Civ. No. A-96-CA-694-JN, 1997 U.S. Dist. LEXIS 13456 (W.D. Tex. Aug. 5, 1997).

158. See Fein, *supra* note 120, at 92 (citing the testimony of former Securities and Exchange Commission Chairman John Shad before the Senate Banking Committee supporting functional regulation).

159. See *Financial Services Restructuring Hearings*, *supra* note 117, at 29 (testimony of Mark Pope, Vice President and Director of Federal Government Relations, Lincoln National Corporation).

160. See generally Fein, *supra* note 120. Due to the state insurance regulatory scheme, an insurer operating nationwide can be subjected to up to 50 different sets of state regulators and regulations.

161. See *id.*

162. Mark Pope, Vice President and Director of Federal Government Relations for Lincoln National Corporation, reiterates this point before a congressional subcommittee by addressing the concern of the national banks that they will now have to deal with up to fifty state regulators instead of just one comptroller. "To them we suggest simply, if you wish to

ultimately bears the cost of regulatory reviews, but the trade off is a regulatory scheme designed to adequately and effectively protect the consumer.¹⁶³

In addition to reducing regulatory conflict, proponents of functional regulation suggest that it will decrease overlap and duplication of the regulatory function. Currently, the OCC permits national banks to conduct certain insurance activities subject to state regulation.¹⁶⁴ The OCC does not interfere, but it does maintain preemptory power if the state's regulation "significantly interferes" or "impairs" a bank's authorized activities.¹⁶⁵ At first glance, this position appears to be an effort by the OCC to provide for functional regulation of bank insurance activities. The OCC, however, has indicated that it would preempt any state law that "restricts a national bank's insurance activity."¹⁶⁶ Arguably, any state insurance law might restrict bank insurance activity and thus create confusion and double regulation.¹⁶⁷ As a result, banks that currently sell insurance are potentially accountable to more than one regulator for the same transaction.¹⁶⁸ Functional regulation would eliminate this duplication of efforts.

be in the insurance business, you should not object to playing by the same rules which govern all other sellers and underwriters of insurance." *The Definitions of Insurance and Banking in H.R. 10: Hearings Before the Subcommittee on Finance and Hazardous Materials of the Committee of Commerce*, 105th Cong. (statement of Mark Pope, Vice President and Director of Federal Government Relations, Lincoln National Corporation) (July 25, 1997), available in 1997 WL 11235301.

163. See *id.*; see also *infra* note 168 and accompanying text. Consumers will benefit from regulators who possess the appropriate knowledge and expertise of the transactions they are regulating.

164. See James M. Cain, *Financial Institutions and Insurance in 1996: Three Strikes, You're Out?*, 52 BUS. LAW. 1117, 1122 (1997) (citing OCC Advisory Letter 96-8, *supra* note 16).

165. See *id.*

166. OCC Advisory Letter 96-8, *supra* note 16.

167. The OCC is relying on the Court's "significantly interferes" language articulated in *Barnett*. See OCC Advisory Letter 96-8, *supra* note 16, at n.7. The OCC interprets that language to "reflect that a relatively small level of impact on the authority of national banks is sufficient to result in federal preemption of the state law at issue." *Id.*

168. In a "White Paper" released by the National Association of Mutual Insurance Companies, the role of the OCC is considered unacceptable. See Steven Brostoff, *NAMIC Announces Support for Federal Financial Services Reform*, NAT'L UNDERWRITER PROP. & CASUALTY-RISK & BEN. MGMT., Apr. 21, 1997, at 4, available in 1997 WL 9332110 ("The current system, in which the OCC is the final arbiter of defining and regulating insurance

Finally, proponents of functional regulation urge that it will result in more effective and consistent oversight. This is achieved by allowing those with the greatest experience in assessing the risks associated with a product's activities¹⁶⁹ to continue to regulate those products by applying a consistent regulatory philosophy.¹⁷⁰ In response, proponents of the entity based regulatory structure argue that the various financial products can be regulated under the same basic legal structure that would be applied under a functional regulatory scheme.¹⁷¹ The only difference, however, would be that the agency responsible for the entity would apply the rules rather than an agency responsible for the product. This argument, however, over-simplifies the issue by assuming that banking regulators and insurance regulators would apply the rules consistently and under the same basic philosophy. The potential for unequal application could create an unlevel playing field for the respective industries.

3. Consumer Protection

Of paramount concern for legislators and industry interest groups is the continuation of consumer protection laws and standards.¹⁷² Many believe that the current regulatory scheme will result in the deterioration of consumer protection laws as banks continue to expand into traditionally state-regulated insurance areas.¹⁷³ Legislators and industry interest groups often cite concerns

activities of banks, is untenable and will result in an expensive, unworkable and discriminatory system of dual regulation.”).

169. See *Once Invincible Ludwig is Put on the Defensive*, *supra* note 94 (“[Banks] have to pay attention to the risks and understand the expertise required in [performing insurance services.] The Academy’s concern is that in the rush toward financial modernization, essential state laws aren’t rehased and [are] weakened.”) (quoting Lauren Bloom, General Counsel of the Academy of Actuaries).

170. See Fein, *supra* note 120, at 92 (citing *Hearings Before the subcommittee on Securities of the Senate Committee on Banking, Housing and Urban Affairs*, 97th Cong. 35 (1982) (statement of John Shad, Chairman, Securities and Exchange Commission)). In addition, many insurance products, especially property and casualty products, are geographically specific. Thus, the task of understanding the issues associated with the various products are more appropriately allocated among various regulators intimately familiar with the area and product. This would be an onerous task for one centralized agency such as the OCC.

171. See *id.* at 107.

172. See Yonan, *supra* note 8.

173. See generally *Life Agents Fear Entry of Banks into Insurance*, BEST’S INS. NEWS, Sept. 23, 1997, available in 1997 WL 7078794. David Malkin, past President of the

such as consumer perception that insurance products are federally insured, illegal tying of bank and insurance products, and the weakening of state insurance licensing laws.¹⁷⁴ Banking regulators are primarily interested in protecting depositors, while state insurance regulators are focused on the well being of policyholders. Proponents of functional regulation urge that because of these different objectives, a federal regulator responsible for both industries may be forced to sacrifice the interests of policyholders in order to boost bank profits and protect depositors.¹⁷⁵ Proponents contend that functional regulation will ensure that consumer protection of both depositors and policyholders is preserved.

Finally, proponents argue that functional rather than entity regulation will encourage the availability of the widest range of financial products at the lowest cost to the public.¹⁷⁶ If a financial service firm fails, it will be on its merits rather than because of arbitrary differences in government regulation.¹⁷⁷ Consumers and industry alike will profit from the new and innovative products encouraged by a market driven system rather than by arbitrary differences in entity regulation.¹⁷⁸ Some argue, however, that

National Association of Underwriters, stresses the importance of state regulation in protecting consumers from the "silent coercion" of the banks. *Id.*

174. See *IIAA Survey*, *supra* note 102.

175. In an analogous situation, Former SEC Chairman John Shad expressed concern over the varying regulatory philosophies of the SEC and federal banking regulators. A bank regulator's "statutory mandate gives priority to the protection of banks and their depositors over protection of investors. Thus, their expertise in the protection of investors is not as great as that of the SEC." Fein, *supra* note 120, at 91 (citing *Hearings Before the Subcommittee on Sec. of the Senate Committee on Banking, Housing and Urban Affairs*, 97th Cong. 9 (1982) (testimony of SEC Chairman John Shad supporting functional regulation)).

176. See Fein, *supra* note 120, at 95, (citing *Blueprint for Reform: The Report of the Task Group on Regulation of Financial Services*, 1050 Fed. Banking L. Rep. (CCH) (Nov. 16, 1984)). In 1984, the Task Group on Regulation of Financial Services, chaired by Vice-President George Bush, prepared a congressional report supporting the concept of functional regulation in the securities industry. See *id.*

177. See *id.* An example of a regulatory advantage noted in the Task Group Report was interest rate controls. See *id.* "The application of interest rate controls to time deposits in depository institutions, while no such controls were applicable to money market funds, was a classic case of the regulatory system failing to regulate fungible products in an equivalent manner, thereby dictating the success of one type of product in the marketplace due to arbitrary differences in regulatory controls." *Id.*

178. See *id.*

functional regulation and particularly the state regulatory scheme will actually act as a disincentive to develop new products.¹⁷⁹ Varying state regulations will make it difficult for a bank to offer its products on an interstate basis. This is not a new problem, however, since insurance companies operating in more than one state are faced with the same concerns. Furthermore, the benefits in focused consumer protection laws tailored to the needs of each state outweigh the regulatory inconvenience facing all of those who chose to engage in insurance transactions.

C. *Current Legislation*

Financial reform has made some progress in the 105th Congressional session. The Financial Modernization Act of 1997, backed by House Banking Chairman, Jim Leach (R-Iowa), has survived the first round of the legislative process. One version of the bill passed the House Banking Committee in June 1997 and another version passed the House Commerce Committee in October 1997.¹⁸⁰ Each version provides for significant reform of laws governing both national banks and insurance companies. The versions are consistent on certain key issues regarding bank insurance powers.

Both versions of the bill prohibit states from preventing or restricting bank and insurance affiliations.¹⁸¹ Furthermore, they propose an alternate form of a bank holding company that will engage in a full range of financial activities, including insurance underwriting.¹⁸² In addition, both versions of the bill retain the authority of the Federal Reserve Board to examine all bank holding companies and their subsidiaries; however, in an effort to reduce costs, the proposed legislation imposes limitations in order to restrict

179. For example, the European Union "views our state-based regulatory system as a barrier to free trade" and thus has threatened to take retaliatory action. Larry G. Mayewski et al., *The New Value Proposition*, BEST's REV., LIFE-HEALTH INS. ED., Jan. 1, 1997, available in 1997 WL 9745370.

180. See Banking Report, *supra* note 127; Commerce Report, *supra* note 127.

181. See Banking Report, *supra* note 127, at § 104; Commerce Report, *supra* note 127, at § 104.

182. See Banking Report, *supra* note 127, at §§ 102-03; Commerce Report, *supra* note 127, at §§ 102-03. These proposals reverse the 1982 amendments to the Bank Holding Act or the Garn-St. Germain Act. See *supra* note 10.

the Board's focus and scope.¹⁸³ Furthermore, both versions of the bill prohibit a national bank and its subsidiary from underwriting insurance except for certain grandfathered activities.¹⁸⁴ However, the proposed legislation does permit insurance agency activities.¹⁸⁵

Despite the similarities in the two versions of the bill, they differ on key issues regarding bank insurance activities. These issues highlight the continued congressional struggle toward financial reform. Since both versions allow national banks to engage in insurance activities, the issue becomes what is the definition of insurance and who is the appropriate regulatory agency. Each version of the bill provides a definition of insurance for both existing and potential products.¹⁸⁶ Each version also establishes a mechanism for resolving disputes over the interpretation of the insurance definition. The Banking Committee bill creates a National Council on Financial Services to resolve disputes arising under the National Bank Act.¹⁸⁷ The Commerce Committee bill, however, calls for an expedited judicial review over definitional disputes of regulators.¹⁸⁸ The court must resolve the conflict "based on its review of the merits . . . without unequal deference."¹⁸⁹ Finally, once the product has

183. See Banking Report, *supra* note 127, at § 131. The Board's examination should be limited "to the fullest extent possible" to the bank holding company itself and any nonbank subsidiary that could have a materially adverse effect on the safety and soundness of any bank affiliate. See *id.*; Commerce Report, *supra* note 127, at § 111. The Board's examination is limited to functionally regulated nondepository institution subsidiaries of bank holding companies that: (1) engage in activities that pose a material risk to an affiliated depository institution, or (2) fail to comply with [the Financial Services Act of 1997] or restrictions on affiliate transactions. See *id.* The Board cannot make a compliance determination without conducting an examination. See *id.*

184. See Banking Report, *supra* note 127, at §§ 141, 151; Commerce Report, *supra* note 127, at §§ 121, 304.

185. See Banking Report, *supra* note 127, at § 141; Commerce Report, *supra* note 127, at § 121.

186. See Banking Report, *supra* note 127, at § 151; Commerce Report, *supra* note 127, at § 304.

187. See Banking Report, *supra* note 127, at §§ 121-22.

188. See Commerce Report, *supra* note 127, at § 307.

189. See *id.* This provision essentially makes the *Chevron* standard of review inapplicable to insurance. See *Chevron, U.S.A., Inc. v. National Resources Defense Council, Inc.*, 467 U.S. 837 (1984) (holding that where a statute is ambiguous, the courts will defer to the reasonable interpretation of the administrative agency); see also *supra* note 53 and accompanying text.

been appropriately classified, only the Commerce Committee version expressly provides for functional regulation of insurance sales activities, including state licensing of insurance agents.¹⁹⁰ The House Banking Committee bill does not have a similar provision.

Despite the significant strides during the 105th congressional session a full house vote is unlikely this session. Neither the insurance nor the banking interests like the idea of oversight of insurance activities by the Federal Reserve as provided for in both proposals.¹⁹¹ Furthermore, key differences involving state regulatory authority and provisions regarding the definition of insurance will continue to cause significant debate. As a result of this and other provisions considered unacceptable by both the insurance and banking industries, financial services modernization legislation is unlikely to be approved in the 105th Congressional Session, which ends in October 1998.¹⁹²

V. CONCLUSION

Regardless of whether the 105th Congress is able to pass financial services reform legislation, future legislative change is inevitable. Reform is necessary in order to provide consumers with new and innovative products. Reform legislation, however, must be carefully crafted to ensure consumer protection. In addition, financial services providers are entitled to fair competition and clearly defined regulatory boundaries. Financial deregulation by administrative interpretation and judicial policy making during the current decade have upset the traditional roles assumed by banks and

190. See Commerce Report, *supra* note 127, at §§ 302-03.

191. See, e.g., *Kentucky Official Seeks Respect for State Regulators*, BEST'S INS. NEWS, July 21, 1997, 1997 WL 7078313. George Nichols III, Kentucky Commissioner of Insurance, stated that he supports the provision of the Banking Committee bill that establishes distinct affiliates, but because the Federal Reserve would be setting reserve requirements, this might impair a state insurance regulator from ensuring proper capital standards. See *id.* Banking interests also are concerned that the OCC has been stripped of its rule-making powers regarding bank insurance activities. For example, Julie Williams, General Counsel for the OCC, stated that "the total package contains significant rollbacks in the current authority of national banks." Letter from Julie Williams, General Counsel, Office of the Comptroller of Currency, to Eugene Ludwig, Comptroller of the Currency (June 24, 1997) (on file with OCC).

192. See *Sun Sets on Financial Modernization*, REG. COMPLIANCE WATCH, Sept. 29, 1997, available in 1997 WL 14246923.

insurance companies. In addition, insurance industry advocates and members of Congress have raised concerns that the OCC's issuance of individual interpretive letters, guidelines, and regulations has complicated the regulatory framework of insurance and that federal comprehensive legislation is necessary.¹⁹³ Furthermore, judicial decisions have effectively endorsed this manner of financial reform.¹⁹⁴

Although recent changes seem to be part of an aggressive, perhaps reckless, advancement of banking interests into new financial arenas, these changes have been the essential catalyst to springboard financial reform. The significant wins for the banking industry, primarily in the courts and regulatory fronts, have forced insurance interests to reevaluate their position on financial affiliations and have brought them to the negotiating table. National banks' current reign, however, will most certainly prove short-lived. Although banks may feel that business as usual is preferable to new legislation, without some cooperation or compromise, they may find the legislative backlash to be detrimental. Thus, the most likely outcome will be a compromise between the two industries that addresses the most significant concerns of each.

National banks are likely to be granted unrestricted access into the insurance and other financial markets. Insurance companies will demand functional regulation and consumer protection laws that ensure a level, competitive playing field. Legislation that addresses these concerns and interests is realistic and obtainable. Repealing section 92 and permitting banks to enter the insurance markets through a functional regulatory scheme will ensure competitive

193. See Glancz et al., *supra* note 88.

194. See, e.g., *Barnett Bank v. Nelson*, 517 U.S. 25 (1996) (discussed *supra* notes 72-75 and accompanying text); *Nationsbank v. Variable Annuity Life Ins. Co.*, 513 U.S. 251 (1995) (discussed *supra* notes 61-67 and accompanying text); *Independent Ins. Agents of Am. v. Ludwig*, 997 F.2d 958 (D.C. Cir. 1993) (discussed *supra* notes 55-59 and accompanying text).

equality, safeguard consumer interests, and provide for less costly, new, and innovative financial services products.

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